6. OVERALL FINANCIAL PERFORMANCE

6.1 CONSOLIDATED RESULTS OF OPERATIONS

($ millions except where otherwise indicated)	2007	2006	2005[2]
Sales	$ 32,815	$ 32,167	$ 31,189
Sales excluding the impact of tobacco sales and VIEs[1]	$ 31,346	$ 30,361	$ 29,120
Operating income	$ 1,094	$ 537	$ 1,634
Adjusted operating income[1]	$ 1,408	$ 1,643	$ 1,891
Interest expense and other financing charges	$ 165	$ 253	$ 187
Net earnings from continuing operations	$ 563	$ 110	$ 716
Net earnings	$ 563	$ 121	$ 698
Basic net earnings per common share from continuing operations ($)	$ 3.92	$ 0.43	$ 5.25
Adjusted basic net earnings per common share from continuing operations ($)[1]	$ 4.26	$ 4.98	$ 5.62
Basic net earnings per common share ($)	$ 3.92	$ 0.52	$ 5.11

(1) See Non-GAAP Financial Measures beginning on page 55.
(2) During 2006, the Company implemented Emerging Issues Committee Abstract 156, "Accounting by a Vendor for Consideration Given to a Customer (Including a Reseller of the Vendor's Products)" ("EIC 156") on a retroactive basis. Accordingly certain sales incentives paid by Loblaw to independent franchisees, associates and independent accounts for prior years have been reclassified between sales and cost of sales, selling and administrative expenses.

Sales and Sales Growth Excluding the Impact of Tobacco Sales and VIEs[1]

($ millions except where otherwise indicated)	2007	2006	2005[2]
Total sales	$ 32,815	$ 32,167	$ 31,189
Less: Sales attributable to tobacco sales	1,013	1,423	1,654
Sales attributable to the consolidation of VIEs	456	383	415
Sales excluding the impact of tobacco sales and VIEs[1]	$ 31,346	$ 30,361	$ 29,120
Total sales growth	2.0%	3.1%	
Less: Impact on sales growth attributable to tobacco sales	(1.4)%	(1.0)%	
Impact on sales growth attributable to the consolidation of VIEs	0.2%	(0.2)%	
Sales growth excluding the impact of tobacco sales and VIEs[1]	3.2%	4.3%	

(1) See Non-GAAP Financial Measures beginning on page 55.
(2) During 2006, the Company implemented EIC 156 on a retroactive basis. Accordingly certain sales incentives paid by Loblaw to independent franchisees, associates and independent accounts for prior years have been reclassified between sales and cost of sales, selling and administrative expenses.

Adjusted Operating Income and EBITDA[1]

($ millions)	2007	2006	2005
Net earnings from continuing operations	**$ 563**	$ 110	$ 716
Add (deduct) impact of the following:			
Minority interest	**130**	(82)	288
Income taxes	**236**	256	443
Interest expense and other financing charges	**165**	253	187
Operating income	**1,094**	537	1,634
Add (deduct) impact of the following:			
Restructuring and other charges	**227**	90	118
Net effect of stock-based compensation and the associated equity derivatives	**109**	60	72
Commodity futures fair value adjustment	**(19)**		(3)
Inventory liquidation	**15**	68	
VIEs	**(11)**	(8)	
Curtailment of post-retirement plan	**(7)**		
Loblaw goodwill impairment charge		800	
Ontario collective labour agreement		84	
Departure entitlement charge		12	
Goods and Services Tax and provincial sales taxes			40
Direct costs associated with supply chain disruptions			30
Adjusted operating income[1]	**1,408**	1,643	1,891
Add (deduct) impact of the following:			
Depreciation and amortization	**704**	705	684
VIE depreciation and amortization	**(33)**	(24)	(26)
Adjusted EBITDA[1]	**$ 2,079**	$ 2,324	$ 2,549

(1) See Non-GAAP Financial Measures beginning on page 55.

Adjusted Basic Net Earnings per Common Share from Continuing Operations[1]

Per common share ($)	2007	2006	2005
Basic net earnings per common share from continuing operations	**$ 3.92**	$ 0.43	$ 5.25
Add (deduct) impact of the following:			
Restructuring and other charges	**0.72**	0.36	0.42
Net effect of stock-based compensation and the associated equity derivatives	**0.63**	0.38	0.46
Commodity futures fair value adjustment	**(0.10)**		(0.02)
Inventory liquidation	**0.04**	0.21	
VIEs	**0.04**		0.03
Curtailment of post-retirement plan	**(0.03)**		
Loblaw goodwill impairment charge		3.84	
Ontario collective labour agreement		0.26	
Departure entitlement charge		0.04	
Direct costs associated with supply chain disruptions			0.09
Goods and Services Tax and provincial sales taxes			0.14
Accounting for Loblaw forward sale agreement	**(0.81)**	(0.40)	(0.77)
Changes in statutory income tax rates	**(0.15)**	(0.14)	0.02
Adjusted basic net earnings per common share from continuing operations[1]	**$ 4.26**	$ 4.98	$ 5.62

(1) See Non-GAAP Financial Measures beginning on page 55.

Consolidated 2007 results reflect the impact of transformational changes being undertaken by both the Weston Foods and Loblaw operating segments in order to position the businesses for strong growth in the future.

In 2007, the Weston Foods operating segment achieved significantly improved financial results despite challenging market conditions. Inflationary commodity cost pressures continued and accelerated in 2007 and this, coupled with a continuation of changing consumer eating preferences and food shopping patterns, led to significant disparity in the financial performance of industry participants. Industry price increases mitigated the higher commodity costs; however, cost and productivity improvements and a mix shift to higher margin products resulted in above average earnings growth for the Weston Foods operating segment.

For the Loblaw operating segment, 2007 was a year of transformational change amid intense competition and pressured earnings. Loblaw's declining financial performance since the beginning of 2005 required action to prevent further erosion. Late in 2006, a significant number of changes in the senior leadership occurred and a strategic review was undertaken which resulted in the identification of a turnaround plan which was built on three core pillars: (i) simplify and sharpen Loblaw by making accountabilities clear and centralizing where it counts, while fixing the basics that matter to customers and matter financially, (ii) restore innovation to the heart of its culture in food and across all of its control labels, and (iii) grow through its Formula for Growth, as previously described in the Operating and Financial Strategies section of this MD&A, while spending capital wisely in an over-spaced market. Loblaw's three to five year turnaround commenced in 2007 and Loblaw has made good progress. The single most important accomplishment has been the organizational restructuring. This is a transformational change that will enable Loblaw, for the first time ever, to fully leverage its national scale. Supply Chain and Information Technology also produced roadmaps that Loblaw believes will make its infrastructure competitive.

Additional activities undertaken by Loblaw in 2006 included the negotiation of a new four-year collective agreement with members of certain Ontario locals of the United Food and Commercial Workers union ("UFCW"), the liquidation of certain general merchandise inventory and the closure of certain underperforming stores. During the third quarter of 2006, a major tobacco supplier commenced shipping directly to certain customers of Loblaw's Cash & Carry and wholesale club network, adversely impacting sales in 2006 and 2007. During 2006, Loblaw also continued to feel the effects from challenges encountered in 2005 during the execution of planned changes to its systems, supply chain and general merchandise areas, including certain supply chain systems conversions and the start-up of a new third-party owned and operated general merchandise warehouse and distribution centre for Eastern Canada which handles general merchandise and certain drugstore products. These challenges disrupted the flow of inventory to Loblaw's stores and resulted in additional operating costs.

The following discussion summarizes the factors and trends that have impacted the Company's financial performance over the past two fiscal years.

In 2007, consolidated sales increased 2.0% to $32.8 billion from $32.2 billion in 2006. Sales growth for 2007 included a negative impact of approximately 1.4% from declining tobacco sales and a positive impact of 0.2% from the consolidation of certain Loblaw independent franchisees as required by AcG 15. Sales excluding the impact of tobacco sales and VIEs[1] increased 3.2% over the prior year. In 2006, consolidated sales increased 3.1% from $31.2 billion in 2005. Sales growth for 2006 included a negative impact of approximately 1.0% from declining tobacco sales and 0.2% from the consolidation of certain Loblaw independent franchisees as required by AcG 15. In 2007, consolidated net earnings from continuing operations increased $453 million to $563 million from $110 million in 2006. In 2006, consolidated net earnings from continuing operations decreased $606 million, or 84.6%, from $716 million in 2005. Consolidated net earnings increased $442 million, or 365.3%, to $563 million in 2007 from $121 million in 2006. In 2006, consolidated net earnings decreased $577 million, or 82.7%, from $698 million in 2005.

The 2007 basic net earnings per common share from continuing operations of $3.92 increased, in line with the increase in consolidated net earnings from continuing operations, when compared to $0.43 in 2006. The 2007 basic net earnings per common share of $3.92 also increased when compared to $0.52 in 2006. Both increases were primarily due to the inclusion in 2006 of a non-cash Loblaw goodwill impairment charge related to the goodwill established on the Loblaw acquisition of Provigo Inc. in 1998.

The Company's consolidated financial statements are expressed in Canadian dollars but a significant portion of its Weston Foods business occurs in United States dollars through its investment in self-sustaining foreign operations in the United States ("U.S. net investment"). Changes in the exchange rate for the United States dollar affect the Company's reported sales, net earnings and the value of the Company's assets and liabilities on its consolidated balance sheet, either positively or negatively, as a result of translating United States dollar denominated transactions and the U.S. net investment into Canadian dollars. In 2007 and 2006, due to the appreciation of the Canadian dollar relative to the United States dollar during the year on a weighted average basis, sales and net earnings growth were negatively impacted. Due to the strengthening of the Canadian dollar relative to the United States dollar from year end 2006, the value of the Company's net assets at year end 2007 was negatively impacted as a result of foreign currency translation. At year end 2006, due to the weakening of the Canadian dollar relative to the United States dollar from year end 2005, the value of the Company's net assets was positively impacted as a result of foreign currency translation.

Over the past two years, Weston Foods has operated in a challenging marketplace impacted by changing consumer eating preferences and food shopping patterns as well as accelerating inflationary cost pressures. Product rationalization and the planned exit of certain products have negatively impacted volume and sales. Additional factors over this two year period include:

- changing consumer eating preferences, including a focus on health and diet, challenged Weston Foods sales growth of certain traditional products including white bread, fresh-baked sweet goods and cookies. These challenges were largely offset by strong growth in the whole grain and higher-priced premium product categories and the development and introduction of new and expanded convenience and health related product offerings, including "on-the-go" individual portioned products, enhanced whole grain and whole wheat offerings, as well as Omega-3, no cholesterol, reduced fat, no trans fat and organic products;
- consumer shopping patterns continue to shift toward alternate format retail channels over traditional, conventional supermarket formats. Weston Foods has successfully penetrated these alternate channels while retaining its strong position in conventional supermarket formats; and
- inflationary cost pressures particularly for wheat, oils and energy have continued and accelerated over the period. Weston Foods achieved sales price increases across many of its product categories, which helped to offset the impact of this cost inflation.

Over the past two years, Weston Foods has increased investment behind its brands, continued to introduce new products geared towards changing consumer eating preferences, and invested capital to support growth, and enhance quality and productivity. These, coupled with a continued focus on customer service, cost improvement and a shift in product mix to higher margin offerings, have resulted in strong financial performance and improved competitive positioning. Management continues to monitor marketplace and competitive developments and believes that Weston Foods is well positioned to take advantage of any opportunities.

Loblaw has been undergoing a significant amount of change over the past two years including changes in senior leadership. Loblaw's three to five year turnaround plan based on Simplify, Innovate and Grow commenced in 2007 and Loblaw has made good progress. There were challenges, as would be expected, with an organizational change of such magnitude. Net earnings in 2007 were pressured by Loblaw's investment in lower retail prices and increased costs including significant expenses in restructuring and consulting.

(1) See Non-GAAP Financial Measures beginning on page 55.

2006 was also a difficult year for Loblaw as it continued to experience the effects in 2006 of certain of its 2005 initiatives which included restructuring of the supply chain operations, supply chain systems conversions, the reorganization of its merchandising, procurement and operations groups and the move of personnel to the head office in Brampton, Ontario. Additional activities undertaken by Loblaw in 2006 included the negotiation of a new four-year collective agreement with members of certain Ontario locals of the UFCW, the liquidation of certain general merchandise inventory and the closure of certain underperforming stores. During the third quarter of 2006, a major tobacco supplier commenced shipping directly to certain customers of Loblaw's Cash & Carry and wholesale club network, adversely impacting sales in 2006 and 2007.

The following analysis details factors that have impacted the Company's consolidated sales and net earnings over the past two years.

Sales

The Company's 2007 consolidated sales increased 2.0% to $32.8 billion from $32.2 billion in 2006. Sales growth for 2007 included a negative impact of approximately 1.4% from declining tobacco sales, and a positive impact of 0.2% from the consolidation of certain Loblaw independent franchisees as required by AcG 15. Sales excluding the impact of tobacco sales and VIEs[1] increased 3.2% over the prior year. The translation of United States dollar denominated sales in the Weston Foods operating segment reduced consolidated sales growth by approximately 0.5%.

Consolidated sales growth for 2007 was impacted by each reportable operating segment as follows:

- Negatively by 0.2% due to the sales decrease of 1.2% at Weston Foods, which included the negative impact of foreign currency translation of approximately 3.4%. Price increases across key product categories combined with changes in sales mix increased sales by 3.5% for 2007. Overall volume decreased 1.3% for 2007 and was negatively impacted by approximately 0.7% due to the combined effect of the exit from the United States frozen foodservice bagel business early in the third quarter of 2006 and the discontinuance of contract manufacturing of biscuits for certain customers during 2006. The remaining volume decline of 0.6% for the year was due to growth in certain higher margin categories being more than offset by declines in other categories.
- Positively by 2.3% due to the sales increase of 2.6% at Loblaw, which included a negative impact of approximately 1.7% from declining tobacco sales, and a positive impact of 0.3% from the consolidation of certain Loblaw independent franchisees as required by AcG 15. Same-store sales increased 2.4% and same-store sales excluding the impact of decreased tobacco sales grew by 3.4%. Loblaw experienced sales growth in all of its regions and concentrated on driving comparable sales growth in its existing asset base. Net retail square footage decreased 0.1 million square feet or 0.2% in 2007 from year end 2006. Corporate store sales per average square foot increased to $591 in 2007 from $585 in 2006.

The Company's 2006 consolidated sales increased 3.1% to $32.2 billion from $31.2 billion in 2005, including a negative impact of approximately 1.0% from declining tobacco sales and a negative impact of approximately 0.2% from the consolidation of certain Loblaw independent franchisees as required by AcG 15. The translation of United States dollar denominated sales in the Weston Foods operating segment reduced consolidated sales growth by approximately 0.7%.

Consolidated sales growth for 2006 was impacted by each reportable operating segment as follows:

- Negatively by 0.1% due to the sales decrease of 0.6% at Weston Foods, which included the negative impact of foreign currency translation of approximately 4.4%. Price increases across key product categories combined with changes in sales mix increased sales by 4.2% for 2006. Overall volume decreased 0.4% for 2006 and was negatively impacted by approximately 0.7% due to the combined effect of the exit from the United States frozen foodservice bagel business early in the third quarter of 2006 and the discontinuance of contract manufacturing of biscuits for certain customers during 2006.
- Positively by 3.2% due to the sales increase of 3.7% at Loblaw, which included a negative impact of approximately 1.2% from declining tobacco sales, and a negative impact of 0.1% from the consolidation of certain Loblaw independent franchisees as required by AcG 15. Same-store sales increased 0.8% and same-store sales excluding the impact of decreased tobacco sales grew by 2.0%. Sales increases were realized across all regions of the country and in all areas of food, general merchandise and drugstore. Net retail square footage increased 1.2 million square feet or 2.5% in 2006. Corporate store sales per average square foot increased to $585 in 2006 from $579 in 2005.

(1) See Non-GAAP Financial Measures beginning on page 55.

Operating Income

The Company's 2007 consolidated operating income increased by $557 million, or 103.7%, to $1,094 million. The consolidated operating margin in 2007 was 3.3% compared to 1.7% in 2006. 2007 consolidated operating income included the following:

- a charge of $227 million related to restructuring and other charges;
- a charge of $109 million for the net effect of stock-based compensation and the associated equity derivatives. The amount of net stock-based compensation cost recorded in operating income is mainly dependent upon the number of unexercised, vested stock options and restricted share units relative to the number of underlying common shares on the equity derivatives and the level of and fluctuations in the market prices of the underlying common shares;
- income of $19 million related to a commodity futures fair value adjustment at Weston Foods;
- a charge of $15 million related to the inventory liquidation at Loblaw;
- income of $11 million related to the consolidation of VIEs by Loblaw; and
- income of $7 million from the curtailment of a post-retirement plan at Weston Foods.

After adjusting for the impact of the items described above, consolidated adjusted operating income(1) for 2007 declined 14.3% to $1,408 million from $1,643 million in 2006.

The Company's 2007 consolidated adjusted operating income(1) was impacted by each of its reportable operating segments as follows:

- Positively by 3.5% due to an increase of 17.5% in adjusted operating income(1) at Weston Foods, including the negative impact of foreign currency translation as a result of the appreciation of the Canadian dollar relative to the United States dollar. Weston Foods adjusted operating income(1) was positively impacted by price increases, the shift in sales mix to higher margin products, and the benefits realized from the continued focus on cost reduction activities.
- Negatively by 17.8% due to a decrease of 22.2% in adjusted operating income(1) at Loblaw. In 2007, Loblaw invested in pricing in specific markets; however, cost reduction lagged the pricing investments which resulted in lower earnings.

The Company's 2007 consolidated adjusted operating margin(1) declined to 4.5% from 5.4% in 2006, and consolidated adjusted EBITDA margin(1) declined to 6.6% from 7.7% in 2006. Consolidated adjusted operating margin(1) declined in 2007 primarily due to the lower adjusted operating margin(1) at Loblaw, partially offset by the higher adjusted operating margin(1) at Weston Foods.

The Company's 2006 consolidated operating income decreased by $1,097 million, or 67.1%, to $537 million. The consolidated operating margin in 2006 was 1.7% compared to 5.2% in 2005. 2006 consolidated operating income included the following:

- a charge of $90 million related to restructuring and other charges;
- a charge of $60 million for the net effect of stock-based compensation and the associated equity derivatives;
- a charge of $68 million related to the inventory liquidation at Loblaw;
- income of $8 million related to the consolidation of VIEs by Loblaw;
- a charge of $800 million related to the non-cash Loblaw goodwill impairment charge;
- a charge of $84 million related to the Ontario collective labour agreement at Loblaw; and
- a charge of $12 million related to a departure entitlement charge at Loblaw.

After adjusting for the impact of the items described above, consolidated adjusted operating income(1) for 2006 was $1,643 million compared to $1,891 million in 2005, a decline of 13.1%.

The Company's 2006 consolidated adjusted operating income(1) was impacted by each of its reportable operating segments as follows:

- Positively by 1.4% due to an increase of 8.7% in adjusted operating income(1) at Weston Foods, including the negative impact of foreign currency translation as a result of the appreciation of the Canadian dollar relative to the United States dollar. In addition, Weston Foods adjusted operating income(1) was positively impacted by sales growth, including price increases in key product categories combined with changes in sales mix, and by the benefits realized from restructuring and other cost reduction activities.
- Negatively by 14.5% due to a decrease of 17.2% in adjusted operating income(1) at Loblaw. Adjusted operating income(1) in 2006 was adversely impacted by the effects of product supply issues, resulting from the implementation challenges arising from the 2005 conversions, and delays in program activities resulted in foregone sales and lost cost leverage on fixed components of operating and administrative expenses. In addition, the continued investment in lower food prices to drive sales growth had a negative impact on adjusted operating income(1). Higher information technology investments in addition to store and distribution centre operational costs, principally labour and higher third-party storage costs, were also incurred. Fixed assets impairment charges were recorded, due in part to a decision to suspend plans for a number of sites scheduled for future development as well as higher general merchandise mark downs taken to clear inventory through normal channels.

(1) See Non-GAAP Financial Measures beginning on page 55.

The Company's 2006 consolidated adjusted operating margin[1] declined to 5.4% from 6.5% in 2005, and consolidated adjusted EBITDA margin[1] declined to 7.7% from 8.8% in 2005. Consolidated adjusted operating margin[1] declined in 2006 primarily due to the lower adjusted operating margin[1] at Loblaw, partially offset by the higher adjusted operating margin[1] at Weston Foods.

The adjustments included to arrive at consolidated adjusted operating income[1] in 2005 were charges related to restructuring, the net effect of stock-based compensation and the associated equity derivatives, supply chain disruptions, the resolution of certain sales tax issues and income associated with the commodities futures fair value adjustment.

Interest Expense and Other Financing Charges

Interest expense and other financing charges consist primarily of interest on short and long term debt, interest and other financing charges on financial derivative instruments, net of interest earned on short term investments and interest capitalized to fixed assets.

In 2007, interest expense and other financing charges decreased $88 million, or 34.8%, to $165 million from $253 million in 2006.

The change is mainly due to:

- Interest expense on long term debt decreased $7 million, or 1.8%, to $386 million from $393 million in 2006 primarily as a result of lower average debt levels.
- Interest on financial derivative instruments, which includes the net effect of the Company's interest rate swaps, cross currency basis swaps and equity derivatives, resulted in a charge of $21 million (2006 – $15 million). The change in interest on financial derivative instruments was due mainly to an increase in United States short term interest rates and the cumulative loss transferred from other comprehensive loss and subsequent change in fair market value of the interest rate swaps previously designated as a cash flow hedge of the variable interest rate exposure on commercial paper.
- Non-cash income of $141 million (2006 – $73 million) was recorded in other financing charges representing the fair value adjustment of Weston's 2001 forward sale agreement for 9.6 million Loblaw common shares. See notes 6 and 24 to the consolidated financial statements for additional information.
- Net short term interest income increased to $53 million (2006 – $38 million) primarily due to higher interest income on United States dollar denominated cash, cash equivalents and short term investments and lower average short term debt levels partially offset by an increase in Canadian short term interest rates.
- Interest expense capitalized to fixed assets increased to $22 million (2006 – $21 million). Loblaw capitalizes interest incurred on debt related to real estate properties under development.

The 2007 weighted average fixed interest rate on long term debt (excluding capital lease obligations and the Exchangeable Debentures) was 6.6% (2006 – 6.6%) and the weighted average term to maturity was 16 years (2006 – 16 years).

In 2006, interest expense and other financing charges increased $66 million, or 35.3%, to $253 million from $187 million in 2005.

The change is mainly due to:

- Interest expense on long term debt decreased $11 million, or 2.7%, to $393 million from $404 million in 2005 primarily as a result of lower average debt levels.
- Interest on financial derivative instruments, which includes the net effect of the Company's interest rate swaps, cross currency basis swaps and equity derivatives, resulted in a charge of $15 million (2005 – income of $1 million). The change in interest on financial derivative instruments was due mainly to an increase in Canadian short term interest rates.
- Non-cash income of $73 million (2005 – $150 million) was recorded in other financing charges representing the fair value adjustment of Weston's 2001 forward sale agreement for 9.6 million Loblaw common shares. See notes 6 and 24 to the consolidated financial statements for additional information.
- Net short term interest income increased to $38 million (2005 – $25 million) primarily due to higher interest rates on United States dollar denominated cash, cash equivalents and short term investments partially offset by higher average short term debt and increased Canadian short term interest rates.
- Interest expense capitalized to fixed assets remained unchanged at $21 million as compared to 2005.

The 2006 weighted average fixed interest rate on long term debt (excluding capital lease obligations and the Exchangeable Debentures) was 6.6% (2005 – 6.6%) and the weighted average term to maturity was 16 years (2005 – 16 years).

(1) See Non-GAAP Financial Measures beginning on page 55.

Income Taxes

The Company's 2007 effective income tax rate decreased to 25.4% from 90.1% in 2006. In 2006, a non-deductible Loblaw goodwill impairment charge was recorded. The effective income tax rate in 2006 before the impact of the non-deductible goodwill impairment charge as presented in note 8 to the consolidated financial statements was 23.6%. The 2007 effective income tax rate was impacted by the following factors:

- the change in the proportion of taxable income earned across different tax jurisdictions and the income tax impact of the non-taxable amounts; and
- a $24 million net reduction to the future income tax expense recognized as a result of changes in the Canadian federal and certain provincial statutory income tax rates, the cumulative effect of which was included in the consolidated financial statements at the time of substantive enactment.

The Company's 2006 effective income tax rate increased to 90.1% from 30.6% in 2005. The increase was mainly the result of the non-deductible Loblaw goodwill impairment charge, which increased the 2006 effective income tax rate by 66.5%. The effective income tax rate before the impact of the non-deductible Loblaw goodwill impairment charge as presented in note 8 to the consolidated financial statements decreased to 23.6% in 2006 from 30.6% in 2005 as a result of the following factors:

- changes in the Canadian federal and certain provincial statutory income tax rates;
- a change in the proportion of taxable income earned across different tax jurisdictions; and
- a $24 million reduction to future income tax expense recognized as a result of changes in the Canadian federal and certain provincial statutory income tax rates, the cumulative effect of which was included in the consolidated financial statements at the time of substantive enactment.

Net Earnings from Continuing Operations

Net earnings from continuing operations for 2007 increased $453 million, or 411.8%, to $563 million from $110 million in 2006. Basic net earnings per common share from continuing operations for 2007 increased $3.49, or 811.6%, to $3.92 from $0.43 in 2006. The 2007 basic net earnings per common share from continuing operations of $3.92 included the impact of the following factors:

- a $0.72 per common share charge related to restructuring and other charges;
- a $0.63 per common share charge for the net effect of stock-based compensation and the associated equity derivatives;
- $0.10 per common share income related to the commodity futures fair value adjustment at Weston Foods;
- a $0.04 per common share charge related to the inventory liquidation at Loblaw;
- a $0.04 per common share charge related to the consolidation of VIEs by Loblaw;
- $0.03 per common share income related to the curtailment of a post-retirement plan at Weston Foods;
- $0.81 per common share non-cash income related to the accounting for Weston's 2001 forward sale agreement for 9.6 million Loblaw common shares; and
- $0.15 per common share income related to the adjustment to future income tax balances resulting from changes in Canadian federal and certain provincial statutory income tax rates.

After adjusting for the above noted items, Weston's 2007 adjusted basic net earnings per common share from continuing operations[1] was $4.26. This represents a 14.5% decrease compared to 2006 adjusted basic net earnings per common share from continuing operations[1] of $4.98, which was adjusted as outlined below.

Net earnings from continuing operations for 2006 decreased $606 million, or 84.6%, to $110 million from $716 million in 2005. Basic net earnings per common share from continuing operations for 2006 decreased $4.82, or 91.8%, to $0.43 from $5.25 in 2005. The 2006 basic net earnings per common share from continuing operations of $0.43 included the impact of the following factors:

- a $0.36 per common share charge related to restructuring and other charges;
- a $0.38 per common share charge for the net effect of stock-based compensation and the associated equity derivatives;
- a $0.21 per common share charge related to the inventory liquidation at Loblaw;
- a $3.84 per common share charge related to the non-cash Loblaw goodwill impairment;
- a $0.26 per common share charge related to the Ontario collective labour agreement at Loblaw;
- a $0.04 per common share charge related to a departure entitlement charge at Loblaw;
- $0.40 per common share non-cash income related to the accounting for Weston's 2001 forward sale agreement for 9.6 million Loblaw common shares; and
- $0.14 per common share income related to the adjustment to future income tax balances resulting from changes in the Canadian federal and certain provincial statutory income tax rates.

(1) See Non-GAAP Financial Measures beginning on page 55.

After adjusting for the above noted items, Weston's 2006 adjusted basic net earnings per common share from continuing operations[1] decreased 11.4% to $4.98 when compared to $5.62 in 2005. The adjustments to basic earnings per common share from continuing operations in 2005 were items related to restructuring, the commodities futures fair value adjustment, supply chain disruptions, the resolution of certain sales tax issues, the net effect of stock-based compensation and the associated equity derivatives, changes in statutory income tax rates, and VIE consolidation, as well as income related to the accounting for Weston's 2001 forward sale agreement for 9.6 million Loblaw shares.

Discontinued Operations

In 2007, the Company had no gain or loss from discontinued operations. The gain from discontinued operations in 2006 was $11 million. The 2006 gain from discontinued operations was primarily related to the final adjustments to the proceeds in 2006 associated with the previously completed 2005 sale of the remaining discontinued Fisheries operations.

For additional information, see note 10 to the consolidated financial statements.

Net Earnings

Net earnings of $563 million in 2007 increased from $121 million in 2006. Net earnings in 2006 decreased to $121 million from $698 million in 2005. Net earnings from continuing operations of $563 million increased from $110 million in 2006. Net earnings from continuing operations decreased to $110 million from $716 million in 2005. Changes in the Company's net earnings and net earnings from continuing operations over the past two years were impacted by the factors described above.

The new accounting standards implemented in 2007 and the resulting impact on the financial position and results of operations are outlined in the Accounting Standards Implemented in 2007 section of this MD&A. The accounting standards implemented in 2006 did not have a material impact on the financial position and results of operations of the Company.

Changes in minority interest did not have a significant impact on growth rates of the Company's net earnings over the past two years as Weston's ownership of Loblaw has not changed over this period.

6.2 CONSOLIDATED FINANCIAL CONDITION

($ millions except where otherwise indicated)	**2007**	2006	2005
Total assets	**$ 18,388**	$ 18,595	$ 18,593
Total long term debt (excluding amount due within one year)	**$ 5,494**	$ 5,918	$ 5,913
Dividends declared per share ($) – Common share	**$ 1.44**	$ 1.44	$ 1.44
– Preferred share:			
Series I	**$ 1.45**	$ 1.45	$ 1.45
Series II	**$ 1.29**	$ 1.29	$ 1.29
Series III	**$ 1.30**	$ 1.30	$ 0.92
Series IV	**$ 1.30**	$ 1.30	$ 0.54
Series V	**$ 1.19**	$ 0.83	

The Company's total assets in 2007 were less than in 2006 and 2005. The decrease in 2007 was primarily due to a significant strengthening of the Canadian dollar relative to the United States dollar, causing a decline in the translated balances of United States dollar denominated assets. The Company's total assets were higher in 2007 than in 2006 on a foreign currency adjusted basis. Accounts receivable also increased in 2007 and 2006. A substantial portion of credit card receivables of *President's Choice* Bank ("*PC* Bank"), a wholly owned subsidiary of Loblaw, is sold to independent trusts and the unsecuritized balance net of the allowance for credit losses increased by $301 million over 2005. After growing in 2006 as a result of capital expenditures in excess of depreciation, fixed assets declined in 2007 as a result of reduced capital expenditures and increased sales of fixed assets. Other assets increased in 2007 and 2006 due to an increase in the fair value of Weston's 2001 forward sale agreement for 9.6 million Loblaw shares, driven by the decline in the Loblaw share price. In addition, the strengthening of the Canadian dollar against the United States dollar increased Loblaw's unrealized cross currency basis swaps receivable in 2007. In 2006, goodwill decreased as a result of the non-cash Loblaw goodwill impairment charge.

(1) See Non-GAAP Financial Measures beginning on page 55.

Cash flows from operating activities have covered a large portion of the funding requirements for the Company over the past two years.

Over the past two years, the Company's funding requirements resulted primarily from:

- the capital investment program;
- dividends paid on common and preferred shares;
- credit card receivables, after securitization; and
- repayment of long term debt.

In 2007, as a result of the strengthening of the Canadian dollar relative to the United States dollar, the change in the cumulative foreign currency translation adjustment negatively impacted shareholders' equity by $508 million. In 2006, as a result of the slight decline of the Canadian dollar relative to the United States dollar, the change in the cumulative foreign currency translation adjustment positively impacted shareholders' equity by $15 million.

Financial Ratios

The Company's 2007 return on average total assets[1] of 6.7% was higher than the 2006 return of 3.2%. The Company's 2006 return on average total assets[1] of 3.2% was lower than the 2005 return of 10.0%. The return in 2006 was negatively impacted by the non-cash Loblaw goodwill impairment charge recorded in operating income as outlined above.

The Company's 2007 return on average common shareholders' equity of 12.7% was higher than the 2006 return of 1.3%. The increase in 2007 was largely the result of higher operating income mainly due to the 2006 non-cash Loblaw goodwill impairment charge and lower interest expense and other financing charges in 2007, including the $141 million non-cash income (2006 – $73 million) related to the fair value adjustment of Weston's 2001 forward sale agreement for 9.6 million Loblaw common shares. The five year average annual return on common shareholders' equity was 13.1%.

The Company's 2006 return on average common shareholders' equity of 1.3% decreased compared to the 2005 return of 16.7%, primarily due to the non-cash Loblaw goodwill impairment charge, incremental costs and charges recorded in operating income as outlined previously and higher interest expense and other financing charges due to the decline in non-cash income to $73 million in 2006 (2005 – $150 million) related to the fair value adjustment of Weston's 2001 forward sale agreement for 9.6 million Loblaw common shares.

The Company's 2007 net debt (excluding Exchangeable Debentures)[1] to equity ratio remained unchanged from 2006 at 0.96:1. The decrease in commercial paper and increase in cash and cash equivalents were offset by decreases in shareholders' equity resulting from the translation of the Company's U.S. net investment due to the appreciation of the Canadian dollar relative to the United States dollar in 2007, partially offset by higher retained earnings.

The Company's 2006 net debt (excluding Exchangeable Debentures)[1] to equity ratio was 0.96:1 compared to the 2005 ratio of 1.02:1. The change in this ratio from 2005 was the result of the following factors:

- the issuance of preferred shares by Weston; and
- an increase in United States dollar denominated cash, cash equivalents and short term investments;

partially offset by:

- lower net earnings primarily due to:
  - lower Loblaw earnings due to the non-cash Loblaw goodwill impairment charge and incremental costs and charges recorded in operating income as outlined previously; and
  - higher interest expense and other financing charges due to the decline in non-cash income to $73 million in 2006 (2005 – $150 million) related to the fair value adjustment of Weston's 2001 forward sale agreement for 9.6 million Loblaw common shares.

The 2007 interest coverage ratio increased to 5.9 times compared to 2.0 times in 2006 due to an increase in operating income and lower interest expense and other financing charges, including the non-cash income of $141 million (2006 – $73 million) recorded in 2007 related to the fair value adjustment of Weston's 2001 forward sale agreement for 9.6 million Loblaw common shares which positively impacted the interest coverage ratio by approximately 2.6 times.

(1) See Non-GAAP Financial Measures beginning on page 55.

The 2006 interest coverage ratio declined to 2.0 times compared to 7.9 times in 2005 due to the non-cash Loblaw goodwill impairment charge, incremental costs and charges as outlined above and higher interest expense and other financing charges, including the non-cash income of $73 million (2005 – $150 million) recorded in 2006 related to the fair value adjustment of Weston's 2001 forward sale agreement for 9.6 million Loblaw common shares. The Loblaw goodwill impairment charge, which is a significant non-cash item in operating income, combined with the non-cash income of $73 million related to the fair value adjustment of Weston's 2001 forward sale agreement for 9.6 million Loblaw common shares, adversely impacted the interest coverage ratio by approximately 1.9 times.

Dividends

The declaration and payment of dividends and the amount thereof are at the discretion of the Board, which takes into account the Company's financial results, capital requirements, available cash flow and other factors the Board considers relevant from time to time. Over the long term, the Company's objective is for its common dividend payment ratio to be in the range of 20% to 25% of the prior year's adjusted basic net earnings per common share from continuing operations[1]. Currently, there is no restriction that would prevent the Company from paying common dividends at historical levels. During 2007, the Board declared quarterly dividends as follows:

($)	2007 Quarterly Dividends Declared per Share
Common shares	$ 0.36
Preferred shares – Series I	$ 0.36
– Series II	$ 0.32
– Series III	$ 0.32
– Series IV	$ 0.32
– Series V	$ 0.30

The 2007 annualized dividend per common share of $1.44 was equal to 28.9% of the 2006 adjusted basic net earnings per common share from continuing operations[1]. Subsequent to year end, the Board declared a quarterly dividend of $0.36 per common share, payable April 1, 2008.

Outstanding Share Capital

The Company's outstanding share capital is comprised of common shares and preferred shares. The following table details the authorized and outstanding common shares and preferred shares.

Share Capital	Authorized	Outstanding
Common shares	Unlimited	129,074,526
Preferred shares – Series I	Unlimited	9,400,000
– Series II	Unlimited	10,600,000
– Series III	Unlimited	8,000,000
– Series IV	Unlimited	8,000,000
– Series V	Unlimited	8,000,000

For preferred shares Series I, Series II, Series III, Series IV and Series V holders, Weston may, at its option redeem for cash, in whole or in part, these outstanding preferred shares on or after the redemption dates specified by the terms of each series of preferred shares. Weston may at any time after issuance give the holders of these preferred shares the right, at the option of the holder, to convert their preferred shares into preferred shares of a further series designated by Weston on a share-for-share basis on a date specified by Weston. In addition, Series II preferred shares are convertible on or after July 1, 2009, at the option of the holder, into a number of Weston common shares determined by dividing $25.00 by the greater of $2.00 and 95% of the then current market price of Weston common shares. Further information on the Company's outstanding share capital is provided in note 21 to the consolidated financial statements.

At year end, a total of 2,299,914 stock options and share appreciation rights were outstanding and represented 1.8% of Weston's issued and outstanding common shares, which was within Weston's guideline of 5%. Further information on Weston's stock-based compensation is provided in note 23 to the consolidated financial statements.

(1) See Non-GAAP Financial Measures beginning on page 55.